S&P Global
Ratings

RatingsDirect®

Summary:

Andover, Massachusetts; General Obligation

Primary Credit Analyst:
Anthony Polanco, Boston + 1 (617) 530 8234; anthony.polanco@spglobal.com

Secondary Contact:
Christian Richards, Boston (1) 617-530-8325; christian.richards@spglobal.com

Table Of Contents

Summary:

Andover, Massachusetts; General Obligation

Credit Profile		
US$11.815 mil GO muni purpose ln ser 2019 due 10/15/2049		
Long Term Rating	AAA/Stable	New
Andover GO		
Long Term Rating	AAA/Stable	Affirmed
Andover GO mun purp ln		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'AAA' rating and stable outlook to Andover, Mass.' series 2019 general obligation (GO) municipal-purpose loan bonds and affirmed its 'AAA' rating, with a stable outlook, on the town's existing GO debt.

Security and the use of bond proceeds

Andover's full-faith-and-credit pledge, subject to Proposition 2 1/2 limitations, secures the bonds.

Due to the town's revenue-raising ability and resource fungibility, however, we rate the limited obligation at the same level as our view of Andover's general creditworthiness. We rate the limited-tax GO debt based on the application of our criteria, titled "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness," published Jan. 22, 2018, on RatingsDirect.

Andover's GO bonds are eligible for a rating above the sovereign because we think the town can maintain better credit characteristics than the nation in a stress scenario. Under our criteria, titled "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," published Nov. 19, 2013, the town has a predominately locally derived revenue source with property taxes generating 75% of general fund revenue. The town also has independent taxing authority and treasury management from the federal government.

Officials plan to use series 2019 bond proceeds to fund various capital items and permanently finance existing short-term debt.

Credit summary

The rating reflects our expectation Andover will likely continue to experience economic growth. Furthermore, we expect management, with well-embedded financial management policies and practices, will likely continue to produce positive financial results during the next several fiscal years.

The rating also reflects our opinion of the town's:

- Very strong economy, with access to a broad and diverse metropolitan statistical area (MSA);
- Very strong financial management, with strong financial policies and practices under our Financial Management

Assessment (FMA) methodology;

- Strong budgetary performance, with balanced operating results in the general fund and an operating surplus at the total governmental-fund level in fiscal 2018;
- Strong budgetary flexibility, with available fund balance in fiscal 2018 at 10.4% of operating expenditures;
- Very strong liquidity, with total government available cash at 22.9% of total governmental-fund expenditures and 5x governmental debt service, and access to external liquidity we consider strong;
- Strong debt-and-contingent-liability position, with debt service carrying charges at 4.6% of expenditures and net direct debt that is 50% of total governmental-fund revenue, as well as low overall net debt at less than 3% of market value and rapid amortization, with 70.2% of debt scheduled to be retired within 10 years, but a large pension and other-postemployment-benefit (OPEB) obligation and the lack of a plan to sufficiently address the obligation in the short-to-medium term; and
- Strong institutional framework score.

Very strong economy

We consider Andover's economy very strong. The town, with an estimated population of 35,392, is in Essex County in the Boston-Cambridge-Newton MSA, which we consider broad and diverse. The town has a projected per capita effective buying income at 199% of the national level and per capita market value of $235,119. Overall, market value grew by 6.7% during the past year to $8.3 billion in fiscal 2019. County unemployment was 3.4% in 2018.

Andover is a primarily residential town. Residential property accounts for about 81% of total assessed value (AV). The town's location, roughly 25 miles north of Boston, on interstates 93 and 495, provides residents with access to a broad range of employment opportunities across the deep and diverse MSA. In addition, commuter-rail stations allow easy travel to downtown Boston.

We posit the town's favorable location is a contributing factor to its strong economic profile. It maintains a sizable, diverse, and high-end local economy. Leading employers include:

- Raytheon Co. (4,750 employees);
- Internal Revenue Service (3,500), a regional service center;
- Phillips Medical (2,000);
- Pfizer (1,200); and
- Putnam Investments (900).

We note that while Phillips Medical is relocating from the town, it will maintain a small presence. Officials, however, indicate a developer is leasing the Phillips site to develop it further. Therefore, the town does not expect a tax disruption. However, other companies, such as Pfizer, are expanding operations.

Management also reports private investment continues to increase; it has been experiencing significant residential growth during the past two years, with officials reporting private investment is at an all-time high, including new developments in the downtown area. Andover has also approved a new mixed-used development, and two new senior-living facilities are now complete. Furthermore, management reports AV has grown rapidly during the past two fiscal years, adding roughly $2.4 million-$2.8 million annually.

Unemployment, which has historically remained below commonwealth and national rates, has shown resilience during past economic downturns. We expect that Andover will likely benefit from its physical location and that management will likely continue to seek opportunities for further property tax base development, which it is currently doing through downtown rezoning and redevelopment, as well as near the commuter-rail station. Consequently, we expect the town will likely maintain its very strong economy.

Very strong management

We view the town's financial management as very strong, with strong financial policies and practices under our FMA methodology, indicating financial practices are strong, well embedded, and likely sustainable.

Andover identifies trends and commonwealth estimates to develop annual revenue and expenditure assumptions, which it then uses to update its five-year budget forecast for capital and budgetary planning. Management regularly monitors the budget; tracks revenue and expenditures; and reports budget-to-actual results to the finance committee, at least, monthly. Management performs midyear budget adjustments, if needed, during special town meetings. Andover has a five-year capital improvement plan (CIP) and capital budget management approves and reprioritizes annually.

The town adheres to a formal debt-management policy when planning and addressing capital needs, including a policy that limits debt service in any one year to 10% of budgeted general expenditures. Officials plan to retire principal during 20 years. Andover's formal reserve policy calls for maintaining reserves between 3% and 7% of expenditures, which it has exceeded recently.

Strong budgetary performance

Andover's budgetary performance is strong, in our opinion. The town had balanced operating results in the general fund at negative 0.1% of expenditures and surplus results across all governmental funds at 2.5% in fiscal 2018. We adjusted fiscal 2018 budgetary performance to account for recurring transfers, as well as bond proceed spending.

Andover achieved balanced fiscal 2018 operating general fund results. According to officials, although revenue was higher than budgeted and expenditures were on target, the town had various capital expenses; this was the main reason for decreased operating results in fiscal 2018 compared with a $4.5 million surplus in fiscal 2017 and a $2.6 million surplus in fiscal 2016. Unaudited fiscal 2019 results show the town, once again, ended with a balanced operating performance at a negative $299,547, or 0.2% of expenditures.

In September 2018, excessive pressure in Columbia Gas-owned natural gas lines sent gas streaming into residential homes, causing a series of explosions and fires throughout Andover and nearby North Andover and Lawrence. Although Andover did not experience any major infrastructure damage, Columbia Gas launched an immense repair effort, replacing many miles of underground piping, meters, and home appliances. Subsequently, Gov. Charlie Baker declared a state of emergency. Officials indicate Columbia Gas fully reimbursed Andover in fiscal 2019 for operational costs, repairs, and damages incurred totaling about $20 million; management has tracked and recorded these funds outside the general fund.

The fiscal 2020, $194.2 million budget is a roughly 4.6% increase from fiscal 2019. The town has estimated new growth at about $2.5 million, representing a five-year average. The town also budgeted for a 3.75% increase in school costs and a 4.5% increase in health insurance. Officials indicate budget-to-actual results are on target, and they do not currently expect negative financial operations during fiscal 2020.

Property taxes generated 75% of fiscal 2018 audited general fund revenue and commonwealth revenue accounted for only 16%. Local collections remain strong, exceeding 99%.

Due to fiscal 2019 estimates and management's record of producing, at least, balanced results, coupled with generally stable regional credit conditions, we expect general fund and total governmental-funds performance will likely remain stable and strong.

However, while we expect our evaluation of budgetary performance to remain strong due to a history of conservative budgeting and pending revenue from new growth, we theorize future pension and OPEB costs could become a budgetary pressure due to funding and closed amortization. We note that management is actively making budgetary adjustments, as needed, for these costs and that it is actively working to reduce the unfunded liability.

The town is funding actuarially determined pension contributions, and it has begun to prefund OPEB. Nevertheless, we think these liabilities could strain future operations, particularly if economic conditions weaken and Andover does not meet actuary assumptions.

Strong budgetary flexibility

Andover's budgetary flexibility is strong, in our view, with available fund balance in fiscal 2018 at 10.4% of operating expenditures, or $19.2 million.

The town has consistently maintained strong budgetary flexibility. For fiscal 2019, unaudited results show available reserves at $19.7 million, or 10.6% of expenditures. We expect available reserves will likely remain stable and at levels we consider strong due to the expectation of strong budgetary performance and a stable credit environment.

Very strong liquidity

In our opinion, Andover's liquidity is very strong, with total government available cash at 22.9% of total governmental-fund expenditures and 5x governmental debt service in fiscal 2018. In our view, the town has strong access to external liquidity if necessary.

Andover has maintained very strong cash during the past three fiscal years. We note the town does not have any contingent-liquidity risk from financial instruments with payment provisions that change upon the occurrence of certain events. We do not consider town investments risky. In addition, in our opinion, Andover's frequent GO bond issuance during the past 20 years demonstrates its strong access to external liquidity. We expect liquidity will likely remain very strong throughout the two-year outlook.

Strong debt-and-contingent-liability profile

In our view, Andover's debt-and-contingent-liability profile is strong. Total governmental-fund debt service is 4.6% of total governmental-fund expenditures, and net direct debt is 50% of total governmental-fund revenue. Overall net debt is low at 1.2% of market value and about 70.2% of direct debt is scheduled to be repaid within 10 years, which are, in our view, positive credit factors.

In our opinion, Andover's large pension and OPEB obligation, without a plan in place we think will sufficiently address the obligation in the short-to-medium term, is a credit weakness. Andover's combined required pension and actual OPEB contribution totaled 8.1% of total governmental-fund expenditures in fiscal 2018: 4.8% represented required contributions to pension obligations and 3.3% represented OPEB payments. The town made 100% of its annual required pension contribution in fiscal 2018.

Following this issuance, Andover has roughly $120.4 million of total direct debt outstanding, roughly $19.3 million of which we consider self-supporting enterprise-related GO debt, based on three years of evidence user charges have provided partial coverage to support these obligations. The town expects to issue about $28 million of additional debt during the next two years to three years, in accordance with its CIP. We do not expect this to alter our view of the town's debt profile, particularly due to rapid principal amortization.

Andover, however, is conducting feasibility studies for the potential replacement of an elementary school and high-school renovations. Although these projects are still in the early planning stages and management has not yet determined potential debt issuances, we expect management will likely maintain stable fixed project costs.

Pension and OPEB highlights include:

- While the town is managing these costs, we think pension and OPEB liabilities will likely remain a long-term credit concern due to lower funding and our expectation that these costs will likely increase.
- Since actuarially determined pension contributions reflect, what we view as, weak assumptions and methodologies, we imagine the risk of unexpected contribution escalations will likely increase. We, however, expect higher contributions will likely remain affordable, at least during the next few fiscal years, due to the strength of the town's revenue base, strong reserves, and conservative budgeting.
- Andover funds OPEB on a pay-as-you-go basis, which, due to claims-volatility and medical-cost and demographic trends, is likely to lead to escalating costs. Management, however, also contributes to an OPEB trust fund with a balance of $12.5 million for fiscal 2019, according to the town.

As of June 30, 2018, Andover participates in:

- Andover Contributory Retirement System (ACRS), which is 46.87% funded with a proportionate share of the town's net pension liability at $162.9 million, assuming a 6.25% discount rate as of fiscal 2018; and
- Andover's defined-benefit, postretirement health-care plan, which is 8% funded with an OPEB liability of about $145.7 million.

ACRS is currently on track for full funding by fiscal 2035, five years ahead of the commonwealth-mandated 2040 deadline. We attribute this low funding to numerous years of underfunding, aggressive assumptions, and weak market performance. While the town is currently managing these costs, contributions will increase by 7.2% annually; contributions could be even higher if market conditions were to weaken and management does not meet actuarial assumptions.

Management's OPEB policy is to contribute 0.4% of the general budget toward the OPEB trust fund, coupled with any health-insurance savings and 100% of the required contribution from water-and-enterprise funds. In accordance with this policy, the town appropriates about $2 million toward the OPEB trust in fiscal 2020, after contributing about $1.8 million in fiscal 2019. Andover has also adopted a plan to fund its OPEB liability in full during the next 36 years.

While we view retirement costs as high, we note the town has managed them. Andover has maintained stable financial performance during the past three fiscal years. In our opinion, however, these costs will likely create long-term budgetary pressure, potentially weakening budgetary performance and reserves.

Strong institutional framework

The institutional framework score for Massachusetts municipalities is strong.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that management will likely continue to produce consistent financial performance, leading to the maintenance of strong budgetary flexibility. In our opinion, a very strong underlying economy and liquidity and strong debt profile provide additional rating stability. Therefore, we do not expect to lower the rating during our two-year outlook. Although unlikely, we could lower the rating if budgetary performance and flexibility were to experience sustained, significant deterioration.

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Criteria Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings, Oct. 7, 2019
- 2019 Update Of Institutional Framework For U.S. Local Governments

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.